

Message Text

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11

ACTION NEA-10

INFO OCT-01 EUR-12 ISO-00 IO-10 SP-02 AID-05 EB-07 NSC-05

CIEP-01 TRSE-00 SS-15 STR-04 OMB-01 CEA-01 CIAE-00

COME-00 FRB-03 INR-07 NSAE-00 USIA-06 XMB-02 OPIC-03

LAB-04 SIL-01 AGR-05 FEA-01 PA-01 PRS-01 /108 W

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R 201340Z JUN 75

FM AMEMBASSY TEL AVIV

TO SECSTATE WASHDC 7187

INFO AMEMBASSY AMMAN

AMEMBASSY BEIRUT

AMEMBASSY CAIRO

AMEMBASSY COPENHAGEN

AMEMBASSY DAMASCUS

AMCONGEN JERUSALEM

LIMITED OFFICIAL USE TEL AVIV 3904

E.O. 11652: N/A

TAGS: EFIN, AFSP, IS

SUBJECT: ISRAEL'S PROPOSED MINI-DEVALUATION SYSTEM

REF: TEL AVIV 3797

BEGIN UNCLASSIFIED

1. GOI'S RATIONALE FOR PROPOSED CRAWLING OR MINI-DEVALUATION SYSTEM IS AS FOLLOWS: NEW MECHANISM WILL:

(1) PROVIDE POSSIBILITY FOR ISRAEL TO KEEP DOMESTIC INFLATION AND ISRAELI

POUND'S EXCHANGE RATE MORE IN LINE, THUS PREVENTING

EROSION OF ISRAEL'S COMPETITIVE EXPORT POSITION AND

CONCOMITANTLY DAMPENING IMPORT DEMAND; (2) DIMINISH

NEED FOR SYSTEM OF TARIFFS AND EXPORT INCENTIVES DESIGNED

TO IMPROVE BALANCE OF TRADE; (3) REDUCE INCEN-

TIVES FOR SPECULATION BECAUSE POTENTIAL PROFIT FROM

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MAXIMUM TWO PERCENT DEVALUATION EVERY THIRTY DAYS WILL

BE OFFSET BY PRESENT COMMERCIAL INTEREST RATES OF APPROXIMATELY TWENTY-TWO PERCENT ANNUALLY;(4) EVEN OUT VARIATIONS IN MONEY SUPPLY DURING PERIODS OF ANTICIPATION OF DEVALUATION;(5) DAMPEN DEMAND FOR MAXIMIZING IMPORTS IN ANTICIPATION OF LARGE DEVALUATION;(6) PREVENT LARGE SHOCK WAVES IN ECONOMY AND SOCIETY WHICH ACCOMPANY LARGE DEVALUATIONS;(7) ELIMINATE SITUATION WHERE LARGE DEVALUATION IS DELAYED BECAUSE OF POLITICAL OR ORGANIZATIONAL CONSIDERATIONS THEREBY GIVING GOVERNMENT ADDITIONAL FLEXIBILITY IN ECONOMIC POLICY ARENA.

2. WHILE GENERALLY EXPECTED, PRECISE TIMING OF FIRST MINI-DEVALUATION SURPRISED MOST ISRAELIS FACT THAT IT WAS DONE ON A TUESDAY EVENING WITH DECISION TAKEN AT CABINET MEETING CALLED ON PRIME MINISTER'S RETURN FROM U.S. RATHER THAN OVER WEEKEND, CONTRIBUTED TO ELEMENT OF SURPRISE. NONE-THE LESS, NO SIGNIFICANT IMPACT ON BUSINESS REPORTED AND BANKS WERE OPEN FOLLOWING DAY.

3. INSTITUTIONAL REACTIONS WERE FAIRLY PREDICTABLE. HISTADRUT SG MESHEL OPPOSED SYSTEMATIC CREEPING DEVALUATION BECAUSE IT WOULD CAUSE INSTABILITY AND NERVOUSNESS. HOWEVER, HE ADDED, IF DEVALUATIONS WERE MADE FROM TIME TO TIME BASED ON OBJECTIVE CRITERIA, IT WOULD BE A LESSER EVIL AND PREFERABLE TO ONE-TIME LARGE DEVALUATION. MESHEL SAID THAT MANUFACTURERS SHOULD ABSORB OFFICIALLY FORECAST ONE-HALF PERCENT PRICE INCREASES RESULTING FROM TWO PERCENT DEVALUATION. NEW PRESIDENT OF MANUFACTURERS ASSOCIATION AVRAHAM SHAVIT COMMENDED DEVALUATION BUT THOUGHT IT SHOULD BE PART OF COMPREHENSIVE PROGRAM INCLUDING CUTS IN GOVERNMENT EXPENDITURE. DEVALUATION'S SUCCESS, ACCORDING TO SHAVIT, WOULD DEPEND ON PUBLIC'S BEHAVIOR AND WHETHER OR NOT IT REFRAINED FROM ADDITIONAL CONSUMPTION AND DEMANDS FOR INCREASED WAGES AND PROFITS. DANIEL RECANATI, MANAGING DIRECTOR, ISRAEL DISCOUNT BANK, SAID DEVALUATION WOULD LESSEN FOREIGN CURRENCY CONVERSIONS THUS DIMINISHING EXPANSION OF MONEY SUPPLY BUT WOULD DELAY TRANSFER OF INVESTMENT CAPITAL IN ANTICIPATION OF BETTER EXCHANGE RATE.

4. NEW EFFECTIVE EXCHANGE RATE FOR IMPORTS IS ISRAELI LIMITED OFFICIAL USE

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POUND 7.04 PER DOLLAR (IL 6.12 PLUS 15 PERCENT GENERAL DUTY) AND FOR EXPORTS IS ISRAELI POUND 6.12 - 7.94 PER DOLLAR, DEPENDING ON VALUE ADDED. DATA FOR FIRST FOUR MONTHS 1975 SHOW NET IMPORTS OF \$1,385 MILLION, A 13 PERCENT INCREASE OVER COMPARABLE PERIOD PREVIOUS YEAR WHILE EXPORTS WERE \$671 MILLION, AN INCREASE OF 17 PERCENT. NEW CRAWLING DEVALUATION SYSTEM DESIGNED TO REDUCE GRADUALLY DIFFERENTIAL BETWEEN EFFECTIVE AND OFFICIAL EXCHANGE

RATES AND THUS COUNTER CRITICISM BY IMF AND OTHER
INTERNATIONAL ORGANIZATIONS OF GOI'S PROPENSITY TO UTILIZE
NUMEROUS EXCHANGE RATES.
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5. EMBASSY COMMENT: WHILE BY NO MEANS A PANACEA FOR
ISRAEL'S ECONOMIC PROBLEMS, PROPOSED SYSTEM OF MINI-
DEVALUATION COULD BE A SMALL BUT SIGNIFICANT STEP IN
CORRECTING BALANCE OF PAYMENTS PROBLEM. IN COURSE OF
TWELVE MONTHS, SUCH DEVALUATIONS WOULD YIELD A TWENTY-
SEVEN PERCENT REDUCTION(AT TWO PERCENT PER MONTH COMPOUNDED
ON AN ANNUAL BASIS)IN VALUE ISRAELI POUND, BUT
GOI HAS STATED THAT IT HAS NO DEFINITE PLANS FOR FUTURE
MINI-DEVALUATIONS. MOREOVER, IT IS NOTE-WORTHY THAT
GOI STILL FREE TO DEVALUE AT HIGHER RATE AT ANY TIME.
NONETHELESS, EMBASSY EXPECTS FREQUENT MINI-DEVALUATIONS
IN NEXT SIX MONTHS IN ORDER TO CORRECT IMBALANCE
BETWEEN OFFICIAL AND REAL EXCHANGE RATES.
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VELIOTES

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: FOREIGN EXCHANGE HOLDINGS, DEVALUATIONS, CURRENCIES
Control Number: n/a
Copy: SINGLE
Draft Date: 20 JUN 1975
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: CunninFX
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1975TELAV03904
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Film Number: D750216-0986
From: TEL AVIV
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1975/newtext/t19750628/aaaaazoc.tel
Line Count: 136
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION NEA
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 3
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: 75 TEL AVIV 3797
Review Action: RELEASED, APPROVED
Review Authority: CunninFX
Review Comment: n/a
Review Content Flags:
Review Date: 12 MAY 2003
Review Event:
Review Exemptions: n/a
Review History: RELEASED <12 MAY 2003 by BoyleJA>; APPROVED <01 DEC 2003 by CunninFX>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
06 JUL 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: ISRAEL'S PROPOSED MINI-DEVALUATION SYSTEM
TAGS: EFIN, AFSP, IS
To: STATE
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 06 JUL 2006